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FISCAL IMPACT STATEMENT

LS 6409 | **NOTE PREPARED:** Jan 16, 2006
BILL NUMBER: HB 1318 | **BILL AMENDED:**

SUBJECT: Research Expense Credit.

FIRST AUTHOR: Rep. Borror | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State
X DEDICATED
FEDERAL

Summary of Legislation: This bill provides that the alternative Research Expense Tax Credit for jet propulsion systems also applies to taxpayers engaged in the production of, or research and development related to, military defense systems. The bill provides that a taxpayer must employ at least 1,000 employees in the United States, including at least 50 employees in Indiana (rather than 3,000 employees) to be eligible to claim the tax credit and extends the tax credit to taxpayers that are primarily engaged in research and development (rather than only those taxpayers that are primarily engaged in production).

Effective Date: January 1, 2007.

Explanation of State Expenditures: *Department of State Revenue (DOR)*: The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the various changes and tax credits contained in this bill. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Eligibility for and Alternative Calculation of the Research Expense Tax Credit:* This bill makes two changes to the Research Expense Credit. First, the bill expands the use of the credit to any taxpayer engaged in the production of, or research and development related to, military defense systems. Second, the bill reduces the current criteria for eligibility for use of the alternative formula. These changes are effective for tax years beginning January 1, 2007, and could potentially affect revenue collections beginning in FY 2007 if taxpayers adjust their quarterly payments. The estimated revenue loss from the expansion of this credit is indeterminable.

Background: P.L. 197-2005 established an alternative calculation of the Research Expense Tax Credit for a taxpayer that: (1) is primarily engaged in the production of civil and military jet propulsion systems; (2) is certified by the Indiana Economic Development Corporation (IEDC) as an aerospace advanced manufacturer; (3) is a U.S. Department of Defense contractor; and (4) maintains one or more manufacturing facilities in Indiana employing at least 3,000 full-time employees in positions that pay on average more than 400% of the hourly state minimum wage. The IEDC is to authorize a taxpayer meeting these requirements to use the alternative calculation method for a taxable year and all subsequent taxable years. The alternative calculation is effective for tax years beginning after December 31, 2005.

This bill expands the eligibility of (1) and (2) above to include military defense system manufacturer or researcher. The bill also changes the employment requirement in (4) so that a taxpayer must employ 1,000 employees in the United States and 50 full-time employees in positions that pay on average more than 400% of the hourly state minimum wage in one or more manufacturing facilities located in Indiana.

The credit under the alternative calculation method is equal to 10% of the difference between: (1) the taxpayer's Indiana qualified research expenses during the taxable year; and (2) 50% of the taxpayer's average Indiana qualified research expenses for the three preceding taxable years.

It is not known how many taxpayers would now qualify for the alternative calculation method. The impact of these changes is indeterminable, but could potentially be significant.

General Information and History About the Research Expense Credit: P.L. 242-2002 (ss) increased this credit from 5% to 10% of qualified expenses for tax years beginning January 1, 2003, and eliminated the apportionment factor used to calculate the credit. P.L. 81-2004 made this tax credit permanent. P.L. 193-2005 increased the credit to 15% on the first $1,000,000 of investment for tax years beginning January 1, 2008, and reduced from 15 to 10 the number of years for which a taxpayer may carry over a research expense credit.

The Research Expense Credit is available for individuals, corporations, limited liability companies, limited liability partnerships, trusts, or partnerships who have increased research activities conducted in Indiana. The credit is calculated based on the increased expenses a taxpayer incurred over their base-year expenditures. The base-year expenditures are measured for taxable years beginning after December 31, 1989, and are equal to the federal base amount as defined in the Internal Revenue Code (2001). A taxpayer is not entitled to a carryback or refund, but may carry forward the tax credit for 10 years. The base-year expenses may not be less than 50% of the current tax year's qualified research expenses.

A history of the Research Expense Credits taken on the individual and corporate tax returns for the last five years is reported in the table below.

History of Research Expense Credits Utilized				
Tax Year	**Tax Rate**	**Indiv. AGI Credits**	**Corp. Tax Credits**	**Total Credits**
1999	5%	$1.6 M	$25.8 M	$27.4 M
2000	5%	$1.6 M	$18.1 M	$19.7 M
2001	5%	$1.2 M	$21.6 M	$22.8 M
2002*	5%	$1.3 M	$12.3 M *	$13.6 M *
2003*	10%	$2.2 M	$14.0 M *	$16.2 M *
** 2002 & 2003 tax year estimates are preliminary due to a large number of suspended returns.*				

Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment. Assuming this economic impact would not have happened absent this incentive, the actual revenue loss from this credit would be mitigated by the incremental increase in other taxes generated by the research activities.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue.

Local Agencies Affected:

Information Sources: Department of State Revenue.

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